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C O N F I D E N T I A L SECTION 01 OF 02 BAKU 000630

SIPDIS

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TAGS: [PGOV](#) [PREL](#) [AJ](#) [TU](#) [ENRG](#)

SUBJECT: AZERBAIJAN STATOIL EXEC SAYS SD1 AND SD2 WILL BE SOLVED TOGETHER

Classified By: Ambassador Anne E. Derse, Reasons 1.4 (b,d)

¶1. (C) SUMMARY: According to a Baku-based StatoilHydro executive, issues relating to the new price of Shah Deniz Phase One gas being sold to Turkey will be solved contemporaneously with agreement of sales of volumes of Shah Deniz Phase Two to Turkey. According to him, there are features of the Shah Deniz Phase One contract that can be used as incentives for the GOT to come to a deal on the sales of Shah Deniz Phase Two gas to Turkey, and, by extension, on providing a fair and transparent transit regime for GOAJ gas seeking European markets. END SUMMARY.

¶2. (C) On June 25 EnergyOff met with StatoilHydro Azerbaijan Vice-President for Gas Jan Heiberg, to discuss the Shah Deniz Consortium's price negotiations with Botas for Shah Deniz Phase One gas (SD1) and also marketing issues for Shah Deniz Phase Two gas (SD2).

¶3. (C) Heiberg said the SD Consortium and Botas has signed a Letter of Agreement stipulating April 15, 2008 as the "trigger date," i.e. the date after which Botas must pay a new price to the SD Consortium for the SD1 gas that until that point was being sold at USD 120 per thousand cubic meters (mcm). Whatever new SD1 price eventually arrived at will be 'grandfathered' back to the April 15 date. Heiberg did not know what the eventual new price would be, but pointed out that Gazprom and Iran are each selling gas to Turkey at a price between USD 400-450/mcm.

¶4. (C) The SD Consortium and Botas have had only two meetings to discuss a new price since signing the letter in April, one in May and one in June. According to both Heiberg and SOCAR Vice-President for Marketing Elshad Nassirov, the meetings have been unproductive, as Botas has rejected both SD Consortium proposed pricing models while not forwarding any of their own. (COMMENT: BP Azerbaijan President Bill Schrader said in a June 30 conversation with the Ambassador that given rising prices, the longer Botas waits to lock in a price, the more it will probably pay for its gas). The next session between the SD Consortium and Botas will be July 16 - 17, at which time the SD Consortium hopes to receive a counter-proposal from Botas.

¶5. (C) Heiberg explained that the "new price" for SD1 will actually consist of both a new starting price ("P-zero"), and an oil-indexed pricing mechanism. He said that negotiating the new SD1 price will be influenced by and will influence the GOT's negotiations to buy SD2 gas, i.e. that there will have to be "one big solution" for all the gas issues between Azerbaijan and Turkey. He quoted Azerbaijan Deputy Speaker of Parliament Valekh Alesgerov, who had told him that "both issues (SD1 and SD2) will have to be solved at once."

¶ 6. (C) Heiberg said that other than price, there were two aspects of the SD1 contract that could be used as a 'sweetener' for SD2 negotiations. For SD1, while the first 80 percent of the contracted volumes were "take or pay," the remaining 20 percent of the SD1 volumes for Turkey were sold with a substantial rebate. Botas is seeking that this price rebate for 2 percent of the SD1 volumes remain non-negotiable, whereas the SD Consortium has said that this rebate is also subject to re-negotiation. Additionally, the current SD1 contract is set to expire in 021. Given that "all of Turkey's supply contracts expire around 2020," the SD Consortium could offer to extend the sales contract.

¶ 7. (C) Heiberg said that the negotiations within the SD Consortium to create a new Special Purpose Vehicle (SPV) to market SD2 gas and to implement sales contracts is deadlocked. (Comment: The SPV for SD1 is the Azerbaijan Gas Supply Company - AGSC - headed by Statoil.) According to Heiberg, SOCAR, who is seeking to play the primary role in marketing SD2 gas, is unwilling to give BP and Statoil the type of "negative control" (i.e. veto power) that these companies feel they require to safeguard what will be an investment of over USD 10 billion.

¶ 8. (C) Heiberg said that SD2 production would be approximately 13 bcm/a. He presumed that approximately three of it would stay in Azerbaijan or Georgia, so that no more than four bcm/a could be sold to Turkey while still leaving enough SD2 gas to sanction one pipeline (i.e. six bcm/a). In

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this regard, he also said that the GOAJ was seeking to have the SD Consortium write a letter on behalf of President Aliyev to Prime Minister Erdogan saying that the GOAJ could not sell more than 4 bcm/a to Turkey.

¶ 9. (C) COMMENT: SOCAR says the SD1 price must be fixed before the SD Consortium will contemplate SD2 sales to Turkey; Botas says that SD2 sales must come first because "SD1 negotiations will take a long time." As Heiberg points out, given that the price of each will determine the price of the other, it is likely that both SD1 and SD2 bilateral issues will probably have to be resolved at the same time.
END COMMENT.

DERSE